BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	CC Docket No. 96-98
Inter-Carrier Compensation for ISP-Bound Traffic	CC Docket No. 99-68

COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE CALIFORNIA PUBLIC UTILITIES COMMISSION

I. INTRODUCTION

The People of the State of California and the California Public Utilities Commission ("California" or "CPUC") respectfully submit these comments in response to a Public Notice, released June 23, 2000 by the Federal Communications Commission ("FCC"), in the above-referenced docket.

On February 26, 1999, the FCC released a declaratory ruling finding that traffic bound for an Internet service provider ("ISP") does not terminate at the ISP's local server, is jurisdictionally mixed and "largely interstate," and is subject to federal jurisdiction.[1] Based on this ruling, the FCC found that such traffic is not subject to the reciprocal

[1] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic, *Declaratory Ruling*, 14 FCC Rcd 3689 (1999).

compensation provision of Section 251(b)(5) of the Telecommunications Act of 1996 ("1996 Act").[2] 47 U.S.C. § 251(b)(5). At the same time, however, the FCC permitted states which have treated ISP-bound traffic as local under interconnection agreements to continue to require local exchange carriers to compensate competitive local exchange carriers under contractual principles or other legal or equitable considerations.

On March 24,2000, the United States Court of Appeals for the District of Columbia Circuit vacated the FCC's ruling, and remanded the matter to the FCC to reconsider its analysis that ISP-bound traffic was not subject to Section 251(b)(5). *Bell Atlantic Telephone Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000). Specifically, the Court found that the FCC had failed to apply its own definition of "termination" in its analysis; had failed to explain why cases governing communications switched by interexchange carriers were applicable to ISP-bound communications; and had failed to explain how its ruling comported with the statutory definition of "telephone exchange service" and "exchange access service" contained in the 1996 Act.[3]

[2] Under Section 251(b)(5) of the 1996 Act, only traffic that is deemed local is subject to the payment of reciprocal compensation. Carriers that transport interstate traffic ordinarily are compensated through access charges, but federal policy prohibits local exchange carriers from imposing access charges on ISPs. Thus, the competitive local exchange carrier cannot collect compensation from ISPs for delivering traffic to them, and, according to the FCC's declaratory ruling, the carrier cannot collect reciprocal compensation for terminating local traffic under Section 251(b)(5) of the 1996 Act.

[3] Section 153(47) defines "telephone exchange service" as "(A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service." Section 153(16) defines "exchange access" as "the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services." 47 U.S.C. §§ 153(47) & (16).

On June 23, 2000, the FCC released a request for comments addressing the shortcomings identified by the Court. California hereby responds to the FCC's request.

II. ISP-BOUND TRAFFIC IS LOCAL IN NATURE FOR THE PURPOSE OF RECIPROCAL COMPENSATION

To date, thirty-three states, including California, have treated ISP-bound traffic as local, and subject to the payment of reciprocal compensation by the local exchange carrier ("LEC") to a competitive local carrier ("CLEC") whose lines the ISP has purchased. Two courts of appeals have affirmed a state's authority to treat ISP-bound traffic as local, and thus eligible for reciprocal compensation. *Southwestern Bell Telephone Co. v. Public Utility Comm'n of Texas*, 208 F.3d 475 (5th Cir. 2000*); Illinois Bell Telephone Co. v. Worldcom Technologies, Inc.*, 1999 U.S. App. LEXIS 20828 (7th Cir. 1999). The D.C. Circuit in turn has rejected the FCC's characterization of ISP-bound traffic as interstate. The decisions of the majority of state regulators and three appellate courts are consistent with the provisions of the 1996 Act, and should be followed by the FCC.

The CPUC itself, in two decisions, has affirmed that ISP-bound traffic is local in nature, and subject to reciprocal compensation. Copies of both decisions are appended hereto.[4] In Decision 98-10-057, issued October 22, 1998, the CPUC explained that, with respect to ISP-bound traffic, a CLEC offers an end user a telecommunications service that is terminated at the ISP modem. The service is local because the distance from the end

[4] The CPUC has consistently applied the reasoning of these decisions in subsequent arbitration proceedings.

user originating the call to the ISP modem occurs within the same local calling area. Upon reaching the ISP modem, the ISP then separately uses its computer network capabilities to send and receive data transmissions over the Internet on behalf of the end user. The ISP's services are unregulated information services. Based on federal regulatory and judicial precedent, the CPUC found that the ISP's services are distinct and severable from the CLEC's regulated telecommunications services. Decision 98-10-057, slip op. at 6-12, citing *California v. FCC*, 905 F.2d 1217, 1240 (9th Cir. 1990). ("When telecommunications services are delivered on an intrastate basis by telephone carriers over telephone lines, they at the very least qualify a services in connection with intrastate communication service by wire… of any carrier.")

On May 18, 2000, the CPUC affirmed its order. Decision 00-05-051. Among other things, the CPUC cited the consistency of its analysis with the judicial precedent discussed above. In particular, the CPUC noted that the D.C. Circuit rejected the argument that the CLEC's telecommunication service does not terminate at the ISP modem simply because the ISP originates additional services beyond the modem. Decision 99-05-051, slip op. at 8. To the contrary, the D.C. Circuit stated that calls to ISPs fall within the definition of "termination" adopted by the FCC. "Termination" is defined by FCC regulation as "the switching of traffic that is subject to Section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." 47 C.F.R. § 51.07(d). Under this definition, calls by end use subscribers to ISPs are switched by the CLEC on behalf of its

customer. The CLEC's customer is the ISP, or called party. *Id*., 206 F.3d at 15. The D.C. Circuit further expressed doubt with the FCC's argument that ISPs purchase "exchange access service," and not "telephone exchange service," as those terms are defined under the 1996 Act. The purchase of "exchange access service" would not entitle a CLEC to reciprocal compensation under Section 251(b)(5), as applied by the FCC. However, as the Court noted, "exchange access service" is for the purpose of originating and terminating toll service. 47 U.S.C. § 153(16). In this case, ISPs are buying service for the purpose of originating and terminating *information* services, not common carrier toll services.

In light of the above, the FCC should find that ISP-bound traffic carried by a CLEC terminates at the ISP's modem, is a severable, local telecommunications service, and is subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act.

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Adoption of these findings not only is consistent with applicable law, but is also consistent with the pro-competitive policies underlying the 1996 Act.

Respectfully submitted,

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July 20, 2000

Decision 98-10-057 October 22,1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

O P I N I O N

By this order, we affirm our jurisdiction over telephone traffic between end users and Internet Service Providers (ISPs), and determine that such calls are subject to the bill-and-keep or reciprocal compensation provisions of applicable interconnection agreements.[5]

III. Background

On March 18, 1998, the California Telecommunications Coalition (Coalition)[6] filed a motion in the Local Competition Docket seeking a ruling regarding the jurisdictional status and billing treatment of telephone calls utilizing a local exchange number to access ISPs. Disputes have arisen in interconnection agreements over which carrier should pay for the cost of

[5] Under standard reciprocal compensation provisions of interconnection contracts, the cost of providing access for a customer's local call that *originates* from one local exchange carrier's network and *terminates* on another local exchange carrier's network is attributed to the carrier from which the call originated. (47 CFR Sec. 51.701(e), 51.703 (1997).) Such "local" calls are distinct from "long distance" calls which merely pass through interexchange switches and involve access charges rather than reciprocal compensation fees.

[6] For purposes of the Motion, the Coalition consists of the following parties: ICG Telecom Group, Inc., Teleport Communications Group, Inc., MCI Telecommunications Corporation, Sprint Communications Co., L.P., Time Warner AxS of California, L.P., Teligent, Inc., California Cable Television Association.

terminating calls originated by customers of the incumbent local exchange carrier (ILEC) to access ISPs which, in turn, are telephone customers of a competitive local carrier (CLC). Typically, an ISP purchases telephone lines located within the local calling area of its customers to provide Internet access by having the customer dial a local number over an ordinary telephone line. Such calls are rated as local, thus allowing the caller to utilize the ISP's service without incurring toll charges. The ISP then converts the analog messages from its customers into data "packets" that are sent through its modem to the Internet and its host computers and servers worldwide.

The Coalition seeks a Commission order affirming that such calls to ISPs should be treated as local calls, under Commission jurisdiction, and subject to the bill-and-keep or reciprocal compensation provisions of applicable interconnection agreements. The Coalition seeks generic resolution of this issue within R.95-04-043, the Local Competition Docket in light of the position advanced by Pacific Bell (Pacific) claiming that calls to an ISP constitute interstate calls. Pacific believes such calls are not subject to this Commission's jurisdiction, and do not qualify for the reciprocal compensation arrangements which are applicable only to local calls. The Coalition claims that, as a result of Pacific's position, CLCs are being unfairly deprived of compensation for terminating ISP traffic. Two complaint cases currently pending before the Commission raise this same issue in the context of specific interconnection agreements in dispute. The Coalition expresses concern that the two complaint cases are likely only the first of many more disputes to come if the Commission does not resolve this issue generically in this proceeding.

Responses to the Coalition's motion were filed on April 2, 1998. Responses in support of the motion were filed by various parties representing CLCs. Responses in opposition to the motion were filed by the two large incumbent

local exchange carriers (ILECs), Pacific and GTE California (GTEC), and by two separate groups of small ILECs.[7] Comments were also filed by Roseville Telephone Company. On April 16, 1998, the Coalition filed a reply to the responses of Pacific and GTEC. On May 8, 1998, Pacific and GTEC each filed a further response to the reply of the Coalition. We have taken parties' comments into account in resolving this dispute.

IV. Position of Parties

The Coalition argues that ISP traffic meets the definition of a local call, and is subject to this Commission's jurisdiction as intrastate traffic, subject to reciprocal compensation requirements. The Coalition measures call "termination" at the point where the call is delivered to the telephone exchange service bearing the called number. The Coalition claims that where an ISP uses a phone line located within the local calling area of its customers, the calls to the ISP terminate when the ISP's modem answers the customers' incoming calls over local phone lines.

The Coalition thus views ISP service as constituting two separate segments, the first of which is a basic local telecommunication service, with the end user's call terminating at the ISP modem. The Coalition views the second segment as a separate data transmission which does not involve telecommunications service, but which is an enhanced information service utilizing worldwide computer networks. If the call did not terminate at the ISP modem, reasons the Coalition, then the ISP would have to be a telecommunications carrier, providing long distance service. Yet, the ISP is

[7] One group of the small ILECs filing comments was comprised of Evans Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Pinnacles Telephone Company, The Siskiyou Telephone Company, The Volcano Telephone Company, and Winterhaven Telephone Company. A second group of small ILECs was composed of Calaveras Telephone Company, California-Oregon Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., The Ponderosa Telephone Company, and Sierra Telephone Company.

treated as a customer by the underlying telecommunications carriers providing the ISP service. In further support of its view that ISP traffic is intrastate in nature, the Coalition cites the FCC's *Access Charge Order* which prescribes that Information Service Providers may purchase services from ILECs under the same intrastate tariffs available to end users.

Other parties representing CLCs support the Coalition's motion, arguing that they have developed business plans based in part on the current industry practice of reciprocal compensation for local calls to ISPs. The CLCs state that the dispute over this issue creates an unacceptable level of uncertainty, warranting expedited Commission action affirming that current industry practice is correct.

The ILECs oppose the Coalition's motion, arguing that ISP traffic is not local, but is interstate in nature, and thus, not subject to this Commission's jurisdiction. As such, the ILECs argue that the Commission has no authority to require reciprocal compensation for termination of ISP traffic, which they claim is subject exclusively to FCC jurisdiction.

Pacific acknowledges that the FCC has permitted ISPs to purchase ILEC services under intrastate tariffs and has exempted ISPs from access charges, but characterizes such actions merely as indicators that the FCC has jurisdiction over these services, but has chosen for policy reasons to forbear from treating the calls as interstate with respect to access charges. The ILECs claim that the very fact that the FCC has exempted Information Service Providers from federal access charges demonstrates that it has jurisdiction over such calls, otherwise the FCC would have had no authority in the first place to grant an exemption for such calls.

The ILECs deny that calls to ISPs "terminate" at the ISP's modem, but argue that such calls remain in transit through the modem for further relay

across state and national boundaries via the Internet. As such, the ILECs define ISP traffic as interstate based on the fact that the ISP sends and receives data transmitted to its local customers which may involve access to computer networks located outside of California or even outside of national boundaries. GTEC argues that a communication must be analyzed, for jurisdictional purposes, from its inception to its completion. GTEC seeks to draw an analogy between the intermediate switching of interstate calls of long distance carriers and the transmission performed by the ISP modem, connecting to worldwide web sites.

GTEC argues that ISP calls involve both intrastate and interstate elements, and as such, are inseverable for jurisdictional purposes. GTEC cites the *Memory Call* case, arguing that in it, the FCC applied an end-to-end analysis to BellSouth's voicemail service to conclude that it was jurisdictionally interstate, even though it utilized an intrastate call forwarding service to allow out-of-state callers to retrieve messages. GTEC argues that a similar analysis should apply to ISP traffic, thereby rendering it jurisdictionally interstate. (Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp, 7 FCC Rcd 1619 (1992).)

The small ILECs raise concern over the impact on their operations if the Commission ruled that ISP traffic be assigned to the intrastate jurisdiction. The rates and revenues of the small ILECs' depend in large measure on calculations based on intra-and-interstate calling traffic ratios. The small ILECs claim that the potential revenue shifts caused by the changes in jurisdictional assignments of the sort addressed in the Motion are so significant that Congress requires such matters to be referred to the Federal-State Joint Board. The small ILECs question the jurisdiction of the Commission to unilaterally decide the jurisdictional assignment of any traffic.

The Coalition also presents a summary of rulings which have been issued by other state commissions concerning whether reciprocal compensation should apply to local calls terminating with ISP end users. The Coalition claims that every state commission that has issued a final decision on this issue has ruled that reciprocal compensation should apply to such calls. While acknowledging that such actions are not binding on this Commission, the Coalition views such decisions as useful information, illustrating how other jurisdictions faced with this same issue have resolved it. In addition, the National Association of Regulatory Utility Commissioners (NARUC) passed a resolution at its November 1997 meeting concluding ISP traffic should remain subject to state jurisdiction.

GTEC discounts the significance of the orders from other jurisdictions cited by the Coalition, arguing that most of the cited orders merely involved interconnection complaints under specific contracts or arbitration proceedings which barely touched upon the ISP traffic issue. To the extent that the cited orders do rule that reciprocal compensation applies to ISP traffic, GTEC claims that the reasoning underlying the orders is faulty.

V. Discussion

The first issue to be resolved is whether calls to an ISP constitute interstate or intrastate local traffic. The question of whether ISP traffic is defined as local or as interstate has a bearing on whether such calls come within the jurisdiction of this Commission and also whether such calls are subject to reciprocal compensation arrangements. Reciprocal compensation provisions of interconnection agreements only apply to local communications, that is, traffic originating and terminating within a local calling area.

There is no question that the Internet services offered by an ISP involves the transmission of information beyond the boundaries of a local calling area, and which may, in fact, span the globe. The Internet itself is an interstate

network of computer systems. The question, however, is whether this network of computer systems comprising the Internet can properly be characterized as a telecommunications network for purposes of measuring the termination point of a telephone call to access the Internet through an ISP. Parties dispute whether such Internet communications can properly be disaggregated into separate components, one involving the telecommunications network, and one that does not. We must consider whether the transmission of data which occurs beyond the ISP's modem constitutes an indivisible part of a total telecommunications service. This question, in turn, depends on how we define a telecommunications service and how such service is terminated.

GTEC argues that the Coalition's attempt to sever the ISP communication into separate intrastate and interstate segments is contrary to legal precedent, but that a communication must be analyzed, for jurisdictional purposes, "from its inception to its completion." (See *Teleconnect Co. v. Bell Te. Co. of Penn. et al.,* 10 FCC Rcd 1626, 1629-30 (1995), aff'd *Southwestern Bell Tel. Co. v. FCC,* No. 95-119 (D.C. Dir. June 27, 1997). GTEC cites a case in which the FCC found that a telephone service was interstate and thus subject to FCC jurisdiction even though the originating caller reached a local telephone number from out of state using foreign exchange and common control switching arrangement services. The service permitted an end user in New York to call an out-of-state customer by dialing a local number and paying local rates. GTEC claims this case is analogous to the dispute over ISP traffic, arguing that both instances involve the use of intrastate local services, in part, to complete an interstate call.

GTEC also cites the *Memory Call* case where the FCC concluded that voice mail service is subject to interstate jurisdiction even though out-of-state callers could retrieve messages using an intrastate call forwarding service. GTEC cites the FCC findings that:

> "The key to jurisdiction is the nature of the communication itself rather than the physical location of the technology. Jurisdiction over interstate communications does not end at the local switchboard, it continues to the transmission's ultimate destination…This Commission has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with the origination and termination of interstate calls." (Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp., 7 FCC Rcd 1620-21 (1992).)

We disagree with GTEC's claim that the FCC's assertion of jurisdiction over voicemail service as cited in the *Memory Call* case has applicability to the ISP issue before us here. Even in instances where interstate services are jurisdictionally "mixed" with intrastate services and facilities otherwise regulated by the states, the FCC ruled that "state regulation of the intrastate service that affects interstate service will not be preempted unless it thwarts or impedes a valid federal policy." (*Id., at 1620 (para. 6).*) Thus, even if ISP traffic did involve the jurisdictional mixing of interstate and intrastate services, state regulation of the intrastate portion of the service would not be preempted since no federal policy is being thwarted or impeded by requiring that such ISP traffic be considered local. The FCC has not issued any regulation on this matter.

Moreover, contrary to its treatment of voice mail and telephone services, the FCC has not categorized Internet use via local phone connections as a single end-to end telecommunications service. The FCC has instead defined Internet connections as being distinctly different from interstate long-distance calls. For example, in its decision not to apply interstate access charges to ISPs, the FCC noted that, "given the evolution in ISP technologies and markets since access charges were first established in the early 1980s, it is not clear that ISPs use the public switched network in a manner analogous to IXCs [long-distance interexchange carriers]." First Report and Order In Re Access Charge Reform. (12 FCC Rcd 15982 at ¶ 345 (Released May 16, 1997).)

Likewise, in the FCC's Report and Order In Re Federal-State Joint Board on Universal Service, 12 F.C.C.R. 8776 (Released May 8, 1997) ("Report and Order"), the FCC concluded that "Internet access consists of more than one component." (*Id.* at ¶ 83.) The FCC reasoned that "Internet access includes a network transmission component, which is the connection over a [local exchange] network from a subscriber to an Internet Service Provider, in addition to the underlying information service." (*Id.*)

The FCC has found that "Internet access services are appropriately classified as information, rather than telecommunications, services." Report to Congress in re Federal-State Joint Bd. On Universal Service, FCC 98-67 at ¶ 73 (Released April 10, 1998). The FCC has affirmed that the categories of "telecommunications service" and "information service" are mutually exclusive. The FCC further concluded that: "Internet access providers do not offer a pure transmission path; they combine computer processing, information provision, and other computer-mediated offerings with data transport." (*Id.*) In contrast to a telecommunications service, the FCC found that: "[t]he Internet is a distributed packet-switched network. . . [where the] information is split up into small chunks or 'packets' that are individually routed through the most efficient path to their destination." (*Id.* at ¶ 64.12.)

The FCC further explained how the service offered by an ISP differs from a telecommunications service:

> "Internet access providers typically provide their subscribers with the ability to run a variety of applications ….When subscribers store files on Internet service provider computers to establish 'home pages' on the World Wide Web, they are, without question, utilizing the provider's capability for . . . storing . .. or making available information" to others. The service cannot accurately be characterized from this perspective as 'transmission, between or among points specified by the user'; the proprietor of a Web page does not specify the points to which its files will be transmitted,

> because it does not know who will seek to download its files. Nor is it 'without change in the form or content,' since the appearance of the files on a recipient's screen depends in part on the software that the recipient chooses to employ. When subscribers utilize their Internet service provider's facilities to retrieve files from the World Wide Web, they are similarly interacting with stored data, typically maintained on the facilities of either their own Internet service provider (via a Web page 'cache') or on those of another. Subscribers can retrieve files from the World Wide Web, and browse their contents, because their service provider offers the 'capability for. . . acquiring, .. . retrieving [and] utilizing. . . information.'" (*Id.* at ¶ 76 (citations omitted); Report and Order, 12 F.C.C.R. 8776 at ¶ 83.)

The FCC's description of Internet service makes it clear that the transmission beyond the ISP modem is an information service, not a telecommunications service. The ISP does not operate switches as does a telecommunications carrier, and does not switch calls to other end users. Rather, the ISP answers the call, signifying that the telecommunications service is terminated at the ISP modem. Once the ISP connection with the local caller is established, the ISP uses its computer network capabilities to send and receive data transmissions over the Internet. These information transmissions are performed utilizing technologies which are independent of the public switched telecommunications network. Moreover, the ISP is not certificated as a telecommunications carrier, and its own manipulations of data transmissions through the Internet computer network cannot properly be defined as a telecommunications service for purposes of measuring where ISP traffic is terminated. Likewise, the transmission of data through the Internet cannot reasonably be construed as an interstate telecommunications service simply because the Internet can route information from worldwide sources.

GTEC argues that the FCC's granting of an exemption from federal access charges to Information Service Providers constitutes a valid inference that the

FCC exclusively regulates traffic. We disagree. The FCC's Access Charge Order was limited to interstate ISP traffic. The FCC did not assert exclusive jurisdiction over intrastate ISP issues. The FCC has historically exercised its jurisdiction over telephone carriers providing interstate enhanced services pursuant to its ancillary jurisdiction under Title I, 47 USC, Sec. 151-155. In 1990, however, the Ninth Circuit Court considered the jurisdictional issue of whether the FCC could preempt the state from the regulation of the intrastate enhanced services offered by carriers. The Ninth Circuit ruled that the state's jurisdiction over carrier-provided intrastate service does not intrude upon the FCC's jurisdiction over interstate enhanced services. The Ninth Circuit explained:

> "[T]he broad language of Sec. 2(b)(1) [of the Communications Act] makes clear that the sphere of state authority which statute 'fences off from FCC reach or regulation, *Louisiana PSC, 476 US at 370,* includes, at a minimum, services that are delivered by a telephone carrier 'in connection with' its intrastate common carrier telephone services. When telecommunications services are delivered on an intrastate basis by telephone carriers over telephone lines, they at the very least qualify as services 'in connection with intrastate communication service by wire ….of any carrier.' (47 USC Sec. 152(b)(1).) That these enhanced services are not themselves provided on a common carrier basis is beside the point. As long as enhanced services are provided by communications carriers over the intrastate telephone network, the broad 'in connection with' language of Sec. 2(b)(1) places them squarely within the regulatory domain of the states." (Emphasis added.)

Based on the analysis above, we find that ISP service does constitute two separate components, one of which is a telecommunications service, and the other which is not. Under the 1996 Telecommunications Act, Congress separately defined "telecommunications" as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." (47 USC 153(43).) On the other hand, Congress defined "information services" as

"the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control or operation of a telecommunications system or the management of a telecommunications service." (47 USC 153(20).) As an information service provider, the ISP is an end user with respect to the termination point of a telecommunications service.

Consistent with the FCC's characterization of Internet service , we conclude that the relevant determinant as to whether ISP traffic is intrastate is the distance from the end user originating the call to the ISP modem. If this distance is within a single local calling area, then we conclude that such call is a local call, and subject to this Commission's jurisdiction. In contrast, long distance voice calls terminate at a remote location outside of the local calling area.

Pacific argues that the telephone numbers for the ISP modem may be located in a different LATA from the CLC switch through which the call passes. In such instances, Pacific argues, the call would not be local, but would be a toll call. While we agree that such calls would be toll calls, we find such an argument to be a red herring. Our finding remains unchanged that the rating of calls should be treated in a consistent manner whether they happen to involve an ISP or any other end user. If the call originates and terminates within the same local calling area, it should be treated as local.

Our finding that calls to the modem of an ISP constitute local telephone traffic does not contradict case law finding that Internet transactions may involve interstate commerce or that the "nature" of a communication, not the physical location of telecommunications facilities, is the proper determinant of FCC jurisdiction. The exercise of jurisdiction by the FCC and Congress includes

authority over the Internet's information service component which involves transmissions across computer networks beyond the ISP modem and the transactions which occur over those networks. The jurisdiction of this Commission covers the intrastate telephone line connection between the ILEC's end user and the ISP modem.

The treatment of an ILEC customer call to an ISP modem as a local call is consistent with our Consumer Protection rules adopted in this proceeding where we defined a "completed call or telephonic communication to be a "call or other telephonic communication, originated by a person or mechanical device from a number to another number which is answered by a person or mechanical/electrical device." (D.95-07-054, App.B, Sec. 2.5.) Based on this definition, the ISP call is properly viewed as terminating at the ISP modem, at which point the originating call is answered, and the ISP connection established. Accordingly, the determination of whether the call is local is based upon whether the rate centers associated with the telephone numbers of the end user and the ISP provider are both within the same local calling area.

Thus, we conclude that we have jurisdiction over the intrastate telecommunications service component of ISP traffic, and thus have authority to deem these calls local.

VI. Payment of Reciprocal Compensation Fees

A. Parties' Positions

The Coalition claims that CLCs are being unfairly deprived of reciprocal compensation fees for terminating the ISP traffic originated by ILEC customers. The Coalition claims Pacific has violated PU Code Sec. 453 by refusing to treat calls to ISPs as local calls eligible for reciprocal compensation. Sec. 453 prohibits public utilities from granting "any preference or advantage to any corporation or person" or subjecting "any corporation or person to any

prejudice or disadvantage" as to "rates, charges, service, facilities or in any other respect …as between classes of service." The Coalition claims that while Pacific collects local measured usage or Zone Usage Measurement (ZUM) Zone 3 charges on the party originating calls to Pacific's own Internet access service , Pacific discriminates against CLCs by refusing to share this revenue for calls from ILEC customers to ISPs served by CLCs. Pacific also receives revenues on flat rate service ($11.25 per month) over the rate for measured rate service ($6.00 per month). The Coalition cites this $5.25 per month differential as compensation for Pacific's costs for usage associated with flat rate service for which there is no extra charge. Likewise, GTEC receives usage revenue on ISP calls, ZUM Zone 3 revenues, and a $7.25 increment over measured rate service in its flat rate charge.

Because Pacific does not share any compensation received from such callers with the CLC that incurs the cost to terminate the call to the ISP, the Coalition claims such differential treatment produces an unfair competitive edge for Pacific and violates Sec. 453(a) and (c). The Coalition argues that CLCs are entitled to receive compensation for terminating inbound calls in the same manner as Pacific and its own Internet operations do. As the volume of ISP traffic continues to grow at explosive rates, the Coalition argues, the CLCs' burden of terminating ISP calls correspondingly grows greater.

Pacific denies the charge that it has violated Sec. 453, arguing that most of its customers pay no additional charge for each individual local call, but are subject generally to local flat rate service. Likewise, Pacific's customers do not pay ZUM Zone 3 charges for ISP calls since CLCs specifically assign telephone numbers to ISPs from NXX codes that permit customers to avoid such charges. Pacific claims that its prices of $11.25 for flat rate service and $6 for measured rate service do not even cover its costs of providing local service to its own customers, much less the costs associated with calls from its customers to

ISPs serviced by a CLC. Pacific argues that these prices were not designed to cover the costs associated with ISP usage where customers maintain their connection to the ISP for extended periods of time. Thus, Pacific denies that it collects any surplus revenues for ISP calls which can be shared with CLCs.

Pacific claims that it would be confiscatory to ILECs to require them to pay CLCs for the termination of ISP traffic. Since virtually all of the ISP traffic is one-way, Pacific argues, the compensating per-minute termination charges would likewise flow asymmetrically to the CLCs that have the customer relationship with the ISPs. The ILEC would thus pay both the costs of originating and terminating ISP traffic.

The ILECs argue that, even if the Commission concludes that it has jurisdiction over such calls, reciprocal compensation for ISP traffic should not be authorized as a matter of policy. Because ISPs receive calls, but almost never originate calls, the CLC would receive payment for terminating ISP traffic, but would seldom, if ever, pay for termination of outgoing calls originating from the ISP. At the same time, the ILEC would have to bear the call origination costs plus the per-minute charges paid to the CLC for terminating the call. The ILECs claim such an arrangement would place an unfair and extraordinary burden on the carrier which originates the call. On the other hand, the CLCs argue that it is they who are disadvantaged by the obligation to terminate calls originated by the ILECs' customers to ISPs.

The ILECs warn that, if ISP traffic is deemed local, and the Commission requires that reciprocal compensation fees apply to ISP traffic, CLCs stand to gain millions of dollars in one-way reciprocal compensation payments under interconnection agreements with the ILECs, thereby subsidizing CLCs' businesses and undermining local competition. GTEC argues that no local carrier would voluntarily serve a subscriber if it stands to pay more in reciprocal

compensation fees than it receives for providing local telephone service to the subscriber. Pacific argues that the payment of termination fees to the CLCs for ISP traffic will create an incentive for CLCs to "game" the system in a competitively abusive manner. Pacific claims that instead of charging ISPs to connect to the CLC network, the CLC can remit some of their reciprocal compensation fees to pay the ISPs for connecting the CLCs in the first place. Pacific believes the payment of reciprocal compensation fees for ISP traffic creates the wrong incentives encouraging such marketing practices.

VII. Discussion

We conclude that provisions applicable to interconnection agreements should apply to the termination of ISP calls as they do to any other local calls. We are unpersuaded by the argument that the payment of termination fees to CLCs for ISP calls is inherently unfair. Parties to the interconnection agreements which are subject to reciprocal compensation for local calls voluntarily agreed to such a provision. In the initial phase of the Local Competition proceeding, both Pacific and GTEC advocated the adoption of reciprocal compensation for call termination. The contractual obligation to pay such charges does not disappear merely because the balance between incoming and outgoing calls is asymmetrical or not to the liking of one party or the other.

The telecommunications network functions that are required to terminate ISP traffic are no different from the functions required to terminate local calls of any other end user. The CLCs incur costs to terminate calls to ISPs just as they do for other calls. Likewise, the ILEC is relieved of the burden of terminating such traffic. We find no legal basis for treating ISP traffic differently from the traffic of any other similarly situated end users.

The fact that such calls flow predominantly in one direction does not negate the costs involved in terminating traffic, nor justify denying carriers

compensation for the termination of local calls to which they are otherwise entitled. The U.S. District Court for the Northern District of California has recently upheld the principle that reciprocal compensation obligations are not invalidated merely because the directional flow of terminating traffic is not symmetrical. In upholding the reciprocal compensation provisions of an interconnection agreement involving a one-way paging carrier, the Court stated:

> "The Court agrees with Cook and the CPUC that nothing in the Act precludes one-way carriers such as Cook from entering into reciprocal compensation agreements with LECs. The Act requires only that the agreements be 'reciprocal' in that each carrier agrees to pay the other for the benefits it receives from the other carrier when the other carrier terminates a call that originates with the first carrier. The compensation agreement between Cook and Pacific Bell does so. Nothing in the statute's language indicates that such compensation agreements are not required if a disproportionate number of calls will originate with the facilities of one carrier or if no calls will originate with those of the other carrier." (Pacific Bell v. Telecom, Inc., U.S. D. C.; Judgment No. C97-03990 Civ.; September 3, 1998)

The imbalance in ISP traffic flow merely reflects the fact that vast majority of telephone customers still are served by an ILEC and thus, most calls will originate with ILEC customers. The ILECs benefit from the huge share of the market they still possess, and generate at least some revenue from the calls to ISPs which are originated by ILEC customers and which terminate on the network of the CLC. For example, the differential rate for flat rate service in excess of measured rate service represents such a source of revenues. Also, the presence of the ISPs enhances the incentive for ILEC customers to purchase second phone lines from which further revenue is generated. It is not confiscatory merely to require the ILEC to compensate the CLC for terminating such calls in conformance with the freely negotiated reciprocal compensation provisions of applicable interconnection agreements. The CLC performs a

necessary function in terminating ISP traffic, thus enabling the communication to be completed. Moreover, as the volume of such traffic increases, the burden on CLCs to provide for the termination of such traffic correspondingly increases. Absent a compensation agreement, the CLC terminating the ILEC customer's call receives no compensation for its termination. It is therefore equitable that the CLC be compensated through termination fees applicable to local calls.

There is nothing discriminatory in requiring that reciprocal compensation apply to ISP traffic since the obligation for reciprocal compensation applies to all carriers, not just to the ILECs. Thus, where calls are originated by CLC customers and terminated by an ILEC to its own ISP customer, the CLC must pay termination fees to the ILEC on whose network the call was terminated. In a competitive local exchange market, ILECs are free to compete for the business of an ISP. If the termination charge is not set at a level which corresponds to the costs incurred in terminating a call, the proper remedy is not to void the requirements of the interconnection agreement prescribing recovery of a termination charge. Rather, the proper remedy would be for the termination charge to be negotiated between the parties to recognize the appropriate costs of call termination and in view of the corresponding revenues received by the carrier on whose network the call is originated. ILEC can renegotiate the interconnection agreements when they terminate to achieve this outcome.

VIII. Impacts on Interstate/Intrastate Calling Ratios

We are unpersuaded by the arguments of the small ILECs that we should refrain from deciding the jurisdictional status of ISP traffic because it could adversely affect the revenues of the small ILECs which is based on intrastate-interstate calling traffic ratios. Our ruling that ISP traffic is intrastate is consistent with the manner in which such traffic has been treated in interconnection agreements historically prior to the recent change initiated by

Pacific in questioning the validity of such treatment. In any event, to the extent that a small ILEC believes it will experience a material revenue impact as a result of a change in jurisdictional calling traffic ratios, it may seek recourse through its general rate case process.[8] Therefore, the issues resolved in this order concerning our jurisdiction over ISP traffic should not have any adverse impact on the traditional manner in which the small ILECs have determined traffic ratios for rate and revenue purposes.

Findings of Fact

1. Disputes have arisen in interconnection agreements over which carrier should pay for the cost of terminating calls originated by customers of one local carrier to access Internet Service Providers (ISPs) which, in turn, are telephone customers of another local carrier.

2. The question of whether ISP traffic is subject to call termination charges depends, in part, on whether such traffic is defined as local or as interstate, and consequently, on whether such calls come within the jurisdiction of this Commission.

3. Provision for reciprocal compensation for call termination in interconnection agreements only applies to local traffic originating and terminating within a local calling area.

4. ISP service is composed of two discrete elements, one being a telecommunications service by which the end user connects to the ISP modem through a local call, the second being an information service by which the ISP converts the customer's analog messages into data packets which are

[8] The dominant large ILECs may seek any remedy they deem necessary to recover from their own end users whatever additional costs are allegedly caused by their end user's calls to ISPs. For example, the ILECs could request modification of the Commission's definition of basic service adopted in D.96-10-066 to possibly add a usage element above a certain threshold of minutes to flat rate service.

individually routed through its modem to host computer networks located throughout the world.

5. Under the 1996 Telecommunications Act (Act), "telecommunications" is defined as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." (47 USC 153(43).)

6. The Act separately defines "information" services" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control or operation of a telecommunications system or the management of a telecommunications service." (47 USC 153(20).)

7. Even where interstate services are jurisdictionally mixed with intrastate services and facilities otherwise regulated by the states, the FCC has ruled that state regulation of the intrastate service will not be preempted unless it thwarts or impedes a valid federal policy.

8. No valid federal policy is thwarted or impeded by a state regulation ruling that reciprocal compensation provisions of interconnection agreements apply to the termination of ISP traffic on another carrier's network.

9. The U.S. Court of Appeals for the Ninth Circuit has ruled that state jurisdiction over carrier-provided intrastate enhanced services such as ISP calls does not intrude upon FCC's jurisdiction over interstate enhanced services offered by carriers.

10. The relevant determinant of whether ISP traffic is intrastate is the whether between the rate centers associated with the telephone number of an end user originating the call and the telephone number at the ISP modem where the call is terminated are both intrastate.

11. If the rate centers associated with the telephone number of the end user originating the call and the telephone number used to access the ISP modem lies within a single local calling area, then such call is a local call.

12. The issues resolved in this order concerning our jurisdiction over intrastate calls to ISPs should not have any adverse impact on the traditional manner in which the small ILECs have determined traffic ratios for rate and revenue purposes.

13. The telecommunications network functions that are required to terminate ISP traffic are no different from the functions required to terminate local calls of any other end user.

14. The fact that ISP traffic flows predominantly in one direction does not negate the costs involved in terminating traffic.

Conclusions of Law

1. This Commission has jurisdiction over transmissions originating from an end user and terminating at an ISP modem where both the end user and modem are intrastate.

2. This Commission has jurisdiction to issue an order ruling on whether a transmission terminating at an ISP is to be subject to the reciprocal compensation provisions of interconnection agreements.

3. The reciprocal compensation provisions applicable to interconnection agreements should apply to the termination of calls to ISPs as they do to any other local calls.

4. There is nothing discriminatory in requiring that reciprocal compensation apply to the ISP termination of calls to by CLCs since the obligation for reciprocal compensation applies to all carriers, not just to the ILECs.

5. It is not confiscatory merely to require the ILEC to compensate the CLC for terminating such calls in conformance with the reciprocal compensation provisions of applicable interconnection agreements.

O R D E R

IT IS ORDERED that:

1. The compensation provisions of interconnection agreements shall apply to the terminating traffic sent by competitive local carriers (CLCs) to Internet Service Providers (ISPs).

2. All carriers subject to interconnection agreements containing reciprocal compensation provisions are directed to make the appropriate reciprocal payment called for in such agreements for the termination of ISP traffic which would otherwise qualify as a local call based on the rating of the call measured

by the distance between the rate centers of the telephone number of the calling party and the telephone number used to access the ISP modem until such agreements are ended. At that time, both the CLCs and incumbent local exchange carriers (ILECs) are free to negotiate whatever new revisions they can agree to for termination.

This order is effective today.

Dated October 22, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
Commissioners

I will file a dissent.

/s/ HENRY M. DUQUE
Commissioner

I will file a dissent.

/s/ JOSIAH L. NEEPER
Commissioner

I will file a concurrence.

/s/ JESSIE J. KNIGHT, JR.
Commissioner

MAIL DATE
5/22/00

Decision 00-05-051 May 18, 2000

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Petition of Pacific Bell for Arbitration of an Interconnection Agreement with MFS/WorldCom Pursuant to Section 252(b) of the Telecommunications Act of 1996.	Application 99-03-047 (Filed March 22, 1999)

ORDER MODIFYING DECISION 99-09-069 AND DENYING REHEARING

INTRODUCTION

Decision (D.) 99-09-069 approved an interconnection agreement between MFS / WorldCom[9] (MFSW) (now MCI WorldCom Communications, Inc.) and Pacific Bell. A total of 163 issues were presented for arbitration. The major issue in the arbitration, however, was the correct treatment of Internet Service Provider (ISP)-bound calls and the correct definition of local calls subject to reciprocal compensation. Also at issue was whether MFSW was entitled to tandem and common transport compensation. MFSW also challenged the use of Pacific's tariffs to establish prices for collocation. Both parties have filed applications for rehearing of the Decision, alleging violations of the Telecommunications

[9] WorldCom Technologies, Inc. was changed to MCI WorldCom Communications, Inc., effective August 10, 1999. Throughout the proceeding, WorldCom Technologies, Inc. was referred to as MFS WorldCom to indicate that the interconnection agreement being arbitrated was that formerly in effect between Pacific Bell and MFS Intelenet of California, Inc. Although the application for rehearing was filed by MCI WorldCom, Inc., it will be referred to as MFSW in order to be consistent with D.99-09-069.

Act of 1996 (Act), and rules and decisions of the Federal Communications Commission (FCC).

Pacific contends that the determination to provide for reciprocal compensation for ISP-bound calls constitutes legal error. MFSW contends that the Decision errs by denying it reciprocal compensation for the call transport and termination service it provides to Pacific Bell at the tandem, common transport, and end office switching prices that Pacific charges MFSW for the same service. In doing so, MFSW argues that the Decision violates section 252(d)(2)(A) of the Act, ¶¶ 1085-1090 of the FCC's Local Competition Order,[10] and 47 CFR § 51.711(a). MFSW argues that the Decision also errs by setting many of the prices for collocation based on Pacific's tariff charges and failing to make those prices subject to true up and adjustment retroactive to the effective date of the interconnection agreement. As such, MFSW contends that many of the prices for collocation are not based on Total Element Long Run Incremental Cost (TELRIC), in violation of the pricing standard of § 252(d) of the Act, 47 CFR §§ 51.501, 51.503, and 51.505, and the Commission's own pricing standard adopted in D.98-02-106.

We find no legal error with respect to this issue raised by Pacific, and we accordingly deny Pacific's application for rehearing. We also find that the Decision does not err with respect to tandem compensation and deny MFSW's application for rehearing on this matter. While we agree that basing collocation prices on Pacific's currently effective Commission-approved tariffs without a true-up constitutes legal error, we resolve the matter by modifying the Decision to provide that Pacific's FCC-approved

[10] First Report and Order, Re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket Nos. 96-98 and 95-185, FCC 96-325 (rel. August 8, 1996).

prices apply when MFSW orders collocation for intrastate purposes. These prices meet the FCC's pricing rules and do not require a true-up. As modified, we accordingly deny MFSW's application for rehearing.

DISCUSSION

Pacific Bell's Application for Rehearing

The basis of Pacific's application for rehearing is that the Commission was legally barred from treating calls to ISPs as local for reciprocal compensation purposes because such calls are jurisdictionally interstate calls under the FCC's February 26, 1999 Declaratory Ruling.[11] Pacific's arguments are similar to those raised by Pacific in other proceedings involving arbitrated interconnection agreements, and should similarly be rejected.

Section 251(b)(5) of the Act requires LECs to establish reciprocal compensation arrangements for the transport and termination of telecommunications. FCC regulations limit the scope of the reciprocal compensation requirement to "local telecommunications traffic." 47 CFR § 51.701(a). In the instant Decision, the Commission noted that the FCC's Declaratory Ruling allows state commissions to continue to determine whether reciprocal compensation is due for ISP-bound traffic. We also found that the Final Arbitrator's Report (FAR) properly based its resolution of this matter on generic Commission policy on reciprocal compensation in D.98-10-057, as modified by D.99-07-047. We upheld the FAR's finding that as long as the respective rate centers of the telephone number assigned to the calling party and to the ISP are within the same

[11] In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, and Inter-Carrier Compensation for ISP-Bound Traffic, Declaratory Ruling and Notice of Proposed Rulemaking, FCC N. 99-38, CC Dkts. 96-98 and 99-68, (rel. Feb. 26, 1999) (Declaratory Ruling).

local calling area, the call shall be defined as a local call, and subject to reciprocal compensation provisions.

Pacific first argues that there is no evidence in the record to support a finding that any ISP-bound calls actually terminate in the same local calling area where the call originated, and that MFSW cannot determine where these calls are finally routed beyond the ISP's modem. Pacific argues that the FCC has ruled that ISP-bound calls do not terminate at the ISP's node, but rather at various websites located in other states and around the world. According to Pacific, the FCC has ruled that this type of traffic is non-local, interstate traffic. Pacific notes that the FCC has ruled that the reciprocal compensation obligations of the Act only apply to traffic that originates and terminates within a local area**.** Pacific defines "terminate" as the location which is ultimately accessed. Since ISP-bound calls are interstate and do not terminate on either MFSW's network or at the ISP's node, Pacific claims that requiring the payment of reciprocal compensation for this traffic violates the Act. According to Pacific, a finding of fact or evidence which suggests that an ISP-bound call actually terminates in the same local calling area where the ISP-bound call originated is essential for the Commission to mandate reciprocal compensation.

Pacific further argues that the Decision is in error as it relies on the earlier ISP Decision D.98-10-057. According to Pacific, since the ISP Decision is "patently erroneous", it was error for the Commission to rely on it. Pacific takes issue with the FAR's conclusion that D.98-10-057 "was an equitable outcome based on its consideration of the telecommunications network functions performed by carriers related to ISP communications and the costs incurred." As Pacific points out, the Decision also notes that

the Commission has discretion to determine whether compensation is appropriate. Pacific argues that D.98-10-057 did not balance the equities, but rather ordered compensation because it found the traffic to be local.

Pacific also complains that the FAR is "notably vague concerning where this 'court of equity' authority is to be found in the Act." According to Pacific, a state commission may impose obligations only if that action is within the limits of the authority the Act itself delegates to state commissions. Otherwise, the state commission would be acting in excess of the authority granted it under the Act. Apparently Pacific argues that in arbitrating interconnection agreements, the Commission's duty is only to ensure that the provisions of the arbitrated agreements meet the requirements of § 251. Since § 251 does not require the payment of reciprocal compensation for ISP-bound traffic (as it is non-local), the Commission cannot require it.

Pacific also claims that it is arbitrary and capricious government action for the FCC to exempt ISP-bound traffic from interstate access charges and the Commission to treat such traffic as local for reciprocal compensation.

Finally, Pacific argues that there is no factual basis to assert an "equitable" outcome regarding reciprocal compensation. According to Pacific, MFSW incurs cost of about $.001 to pass the calls to its ISP customers, and without reciprocal compensation for calls to ISPs, MFSW admits its service to ISPs is "close to break-even." Yet, Pacific complains, the FAR has Pacific paying MFSW about $.002 for every ISP-bound minute of traffic. Pacific takes issue with the FAR's justification for this payment on the basis that MFSW incurs costs that are unrecovered without reciprocal compensation, and MFSW would have to increase charges to the

ISP to recover its costs of call termination. According to Pacific, paying MFSW more than its costs is not equitable.

Discussion

We have consistently rejected Pacific's arguments in the past, holding that the imposition of reciprocal compensation for ISP-bound traffic does not violate federal law. (See, e.g., In re Petition of Pacific Bell, Inc. for Arbitration of an Interconnection Agreement with Pac West Telecom, Inc., D.99-12-025; In re Competition for Local Exchange Service, D.99-07-047.) We have characterized Pacific's arguments as an incomplete and inaccurate reading of the FCC's Declaratory Ruling. Id. While the FCC found these calls to be "largely interstate" for jurisdictional purposes, the FCC also found "no reason to interfere with state commission findings as to whether reciprocal compensation provisions of interconnection agreements apply to ISP-bound traffic…." Declaratory Ruling ¶ 21. The FCC further acknowledged that its "policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that [reciprocal] compensation is due for that traffic." Id., ¶ 25. As the Fifth Circuit recently stated, "[c]learly, then, whether voluntarily negotiated or confected through arbitration, commission-approved agreements requiring payment of reciprocal compensation for calls made to ISPs do not conflict with §§ 251 and 252 of the Act or with the FCC's regulations or rulings." Southwestern Bell Telephone Co., v. Public Util. Comm'n of Texas, et al., Case No. 98-50787 (March 30, 2000).

Pacific's argument concerning allegedly conflicting treatment of ISP-bound traffic by the Commission and the FCC overlooks the many court cases which have upheld state commission decisions imposing reciprocal

compensation provisions as harmonious with both the FCC's Declaratory Ruling and the Act. The Seventh Circuit in Illinois Bell Telephone Co., d / b / a Ameritech Illinois v. WorldCom Technologies, et al. (7th Cir. 1999) __ F.3d __, 1999 U.S. App. LEXIS 13668 ("Illinois Bell"), for example, affirmed the decision of the Illinois Commerce Commission ("ICC") requiring Ameritech to pay reciprocal compensation for ISP-bound traffic. The Court found the ICC decision fully consistent with the FCC's Declaratory Ruling: "The ICC's conclusion –that reciprocal compensation should apply to traffic Ameritech bills as local traffic –does not violate the Act or the FCC's interpretation of the Act." 1999 U.S. App. LEXIS 13668, *18-19. The Seventh Circuit accepted both the FCC's and the ICC's legal analyses, which taken together allow ISP-bound traffic to be treated as interstate for FCC jurisdictional purposes, but as local for purposes of reciprocal compensation.

The courts have also upheld state commission decisions which relied on the "two call theory" in determining whether reciprocal compensation was appropriate for ISP-bound traffic. The Fifth Circuit recently upheld a Texas PUC decision which had divided Internet traffic into two components to determine where the call "terminates." Citing the Declaratory Ruling, the Court stated, "[p]erceiving such calls as terminating locally for compensation purposes is clearly condoned by the FCC." Southwestern Bell Telephone Co., v. Public Util. Comm'n of Texas, et al., Case No. 98-50787 (5th Cir.) (March 30, 2000).

Moreover, the FCC recognized that sufficient authority exists under § 252 to authorize state regulatory commissions to require reciprocal

compensation for ISP-bound traffic.[12] Section 252 confers jurisdiction on state commissions to resolve open issues in an arbitration, and extends to issues not addressed by § 251(b)(5). The Supreme Court also has recognized that the Act cannot divide the world of domestic telephone service "neatly into two hemispheres," one consisting of interstate service, over which the FCC has plenary authority, and the other consisting of intrastate service, over which the states retain exclusive jurisdiction. Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 360, 106 S.Ct. 1890, 1894 (1986). The Fifth Circuit in Southwestern Bell, supra, held that the Texas PUC properly exercised its jurisdiction regardless of any interstate aspect of the subject telecommunications.

Based on the foregoing reasons, we have consistently rejected Pacific's arguments in the past. Now, however, there is another basis for denying Pacific Bell's application for rehearing. On March 24, 2000, the D.C. Circuit Court of Appeals vacated the FCC's Declaratory Ruling. In Bell Atlantic Telephone Companies v. Federal Communications Commission, Case No. 99-1094 (March 24, 2000), the D.C. Circuit found the FCC did not provide a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as "terminat[ing]…local telecommunications traffic," and why such traffic is "exchange access" rather than "telephone exchange service."

The D.C. Circuit found fault with the FCC's application of the "end-to-end" jurisdictional analysis to determine whether ISP-bound traffic is "local" for purposes of its regulation limiting § 251(b)(5) reciprocal compensation to local traffic. The Court stated there was no explanation why the end-to-end inquiry is relevant to discerning whether a call to an

[12] The D.C. Circuit Court of Appeals did not reach the objections of incumbent LECs that §

ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

The Court found that the cases the FCC relied on for using the end-to-end analysis were not on point, as they involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination. The Court stated that even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation. The FCC had not satisfactorily explained why the original communication does not "terminate" at the ISP, and why an ISP is not, for purposes of reciprocal compensation, a communications-intensive business end user selling a product to other consumer and business end-users.

The FCC tried to counter that although the call from the ISP to an out-of-state website is information service for the end-user, it is telecommunications for the ISP, and thus the telecommunications cannot be said to "terminate" at the ISP. The Court rejected this argument, noting that the mere fact that the ISP originates further telecommunication does not imply that the original telecommunication does not "terminate" at the ISP.

The Court also noted a series of FCC rulings dealing with enhanced service providers (ESPs), of which ISPs are a subclass, which indicate that calls to ISPs are not like long-distance calls and have been treated as local for regulatory purposes:

251(b)(5) preempts state commission authority to compel payments to the competitor LECs.

> [The FCC has] referred to calls to information service providers as local … When accused of inconsistency in the present matter, the [FCC] flipped the argument on its head, arguing that its exemption of ESPs from access charges actually confirms "its understanding that ESPs in fact use interstate access service; otherwise, the exemption would not be necessary." … This is not very compelling. Although, to be sure, the Commission used policy arguments to justify the "exemption," it also rested it on an acknowledgment of the real differences between long-distance calls and calls to information service providers.

Bell Atlantic, 2000 WL 273383 at *7.

The D.C. Circuit's decision has a number of implications. First, since many of Pacific's arguments are predicated on the Declaratory Ruling, it may be argued that Pacific's allegations have been rendered moot or legally irrelevant in light of this recent development. For example, now that the FCC's order has been vacated, the Commission's earlier analysis in D.98-10-057 concluding that this traffic does indeed "terminate" at the ISP's modem is no longer inconsistent with any existing FCC determination. Since there currently is no classification of this traffic at the FCC level, there can be no conflict between this Commission's Decision and any FCC rule or regulation, as Pacific alleges.

Second, the vacatur of the FCC's Declaratory Ruling leaves open the possibility that reciprocal compensation is in fact *required* for ISP-bound calls pursuant to §§ 251 and 252 of the Act. Although this Commission utilized the "two-call theory" in D.98-10-057 and found that the telecommunications portion of the call terminates at the ISP's modem, that decision never stated that reciprocal compensation was required as a result of § 251(b)(5) of the Act. (Instead, in an independent analysis the Commission found that reciprocal compensation provisions did apply to ISP-bound traffic in California based on other legal and equitable reasons.)

Section 251(b)(5) and federal rules require reciprocal compensation for the transport and termination of local telecommunications traffic. The D.C. Circuit indicated that calls to ISPs appear to meet the FCC's regulatory definition[13] of "termination": "Calls to ISPs appear to fit this definition [of termination]: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'" Bell Atlantic at 5, 2000 WL 273383 at *5. Accordingly, it may be argued that reciprocal compensation is in fact required for ISP-bound traffic pursuant to the Act.

Whether reciprocal compensation is in fact required for this traffic need not be addressed at this time in order to resolve Pacific's application for rehearing. There is currently no classification of ISP-bound communications at the FCC level. As discussed above, neither the Act nor any federal rules prohibit requiring reciprocal compensation for ISP-bound traffic. Moreover, this Commission's earlier decisions relating to the appropriate treatment of IS-bound traffic remain in effect.[14] Accordingly, Pacific has failed to establish legal error in the Decision.

There is also no merit in Pacific's argument that the Decision is inequitable by requiring Pacific to pay MFSW $.002 a minute to terminate calls to ISPs. According to MFSW, Pacific does not accurately portray the facts concerning the costs MFSW's incurs to terminate calls to ISPs. As MFSW's witness testified, he was not aware of any cost study done to identify MFSW's costs of terminating calls to ISPs. In addition, the cash

[13] Call termination for reciprocal compensation purposes is defined as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." 47 CFR § 51.701(d).

[14] Call termination for reciprocal compensation purposes is defined as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." 47 CFR § 51.701(d).

flow analysis to which he testified identified profitability at $.002 per minute. In any case, under the FCC's rules the ILEC's costs are to be used as a proxy for the costs of the competitive local exchange carrier. 47 CFR § 51.711(a)(1). D.99-09-069 is consistent with that requirement as it uses Pacific's costs of termination at the end office level as a proxy for MFSW's costs of termination.

In light of the above discussion, Pacific's application for rehearing should be denied. Pacific has failed to meet its burden of establishing legal error in the Decision.

MFSW's Application for Rehearing

Tandem Interconnection Rate

MFSW contends that D.99-09-069 errs by denying MFS WorldCom reciprocal compensation for the call transport and termination service it provides to Pacific at the tandem, common transport, and end office switching prices that Pacific charges MFS WorldCom for the same service. By doing so, MFS argues that the Decision violates § 252(d)(2)(A) of the Act, ¶¶ 1085-1090 of the FCC's Local Competition Order[15], and 47 CFR § 51.711(a).

The Act requires that parties to interconnection agreements pay each other reciprocal compensation -- each party must pay the other for transporting and terminating on its network calls that originate on the other's network. 47 U.S.C. §§ 251(b)(5) & 252(d)(2)(A). The compensation must be based on the cost of transporting and terminating the call. Id. The cost of transporting a call through a tandem switch and then to an end

[15] First Report and Order, Re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket Nos. 96-98 and 95-185, FCC 96-325 (released August 8, 1996).

office switch is more than the cost of transporting a call directly to an end office switch.

The FCC in its First Report and Order determined that where a CLC's switch or other technology serves a geographic area comparable to the incumbent's tandem switch, then the CLC is entitled to be compensated at the higher tandem rate:

> States may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to an end office switch. In such cases, states shall also consider whether new technology (e.g. fiber rings or wireless networks) perform functions similar to those performed by an incumbent LEC's tandem switch and thus, whether some or all of the calls terminated on the new entrant's network should be priced the same as the sum of transport and termination via the incumbent LEC's tandem switch. Where the interconnection carrier's switch serves a geographic area comparable to that served by the incumbent LEC's tandem switch, the appropriate proxy for the interconnecting carrier's additional costs is the LEC tandem interconnection rate.

First Report and Order ¶1090; 47 C.F.R. § 51.711(a)(3).

Thus, the relevant inquiry in determining whether MFSW can charge Pacific the full tandem rate for all local and ISP-bound calls Pacific terminates to MFSW is whether MFSW's network functions as a tandem switch and whether it covers a comparable geographic area as Pacific's tandems.

The Draft Arbitrator's Report (DAR) found that MFSW was entitled to charge Pacific the full tandem rate for local traffic. The DAR found that MFSW's SONET ring network architecture provided switching and transport functions which are functionally equivalent to the service that

Pacific provides and serves a comparable geographic area as do Pacific's tandems. The DAR reasoned:

> In contrast to Pacific's network, MFSW's local loops can traverse several serving wire center territories to get between a customer and the serving switch. Thus, MFSW's SONET rings connect the switching node to the transport nodes, providing a similar functionality to Pacific's "common transport."
>
> The fact that MFSW's costs may be lower in providing equivalent functions does not justify the payment of a lower level of compensation to MFSW in comparison to Pacific. The FCC has concluded that "it is reasonable to adopt the [ILEC's] transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination." (FCC First Report and Order ¶ 1085). By setting the compensation levels at parity, a carrier is able to be rewarded for any efficiency gains resulting from utilizing advanced network architectures, thereby promoting carriers' incentives to become more innovative and competitive. Accordingly, MFSW is entitled to receive compensation for providing those tandem and transport functions to Pacific on a reciprocal basis. MFSW thus shall be compensated at the same tandem and common transport rates that it pays to Pacific.

DAR at 76-77.

The FAR reversed this position. The FAR found that where MFSW provides no tandem or common transport functions and thus incurs no such costs, it is not entitled to compensation for those functions and costs. The FAR concluded that MFSW's switches do not serve the same or comparable area as Pacific, and thus MFSW's claim that it is entitled to reciprocal compensation for those functions was rejected:

> Even if MFSW's switch served a comparable geographic area to that of Pacific, the cited language would only justify payment of the tandem rate, but not also the common transport or end office rates as sought

> by MFSW. Moreover, while the payment of the tandem rate requires that the switches of each carrier serve a comparable area, MFSW has not shown that its switches will meet this requirement. MFSW has not established interconnection points throughout the tandem serving area, but generally requires Pacific to provide the bulk of the transport between each carrier's switches by its choice of interconnection points. Although MFSW witness Sigle contends that the area served by MFSW's switches and fiber ring facilities is generally the same area as served by Pacific's tandem, the support offered for this claim is unconvincing. Any similarity in the size of serving areas will soon go away when MFSW's new switches are in place. Moreover, many of MFSW's customers are not served by these fiber rings. For example, the ISPs which make up a significant portion of MFSW's business are actually collocated with MFSW's switch.

FAR at 80.

MCI first argues that the Commission erred as a matter of law as it failed to correctly apply 47 CFR § 57.711(a). MFSW argues that instead of performing the relevant inquiry, the Commission instead looked at whether the CLC actually provided a tandem or common transport function. As MFSW points out, the Decision states that MFSW's position "would provide tandem and common transport compensation to MFSW even when Pacific does not incur those costs." D.99-09-069 at 16. MFSW argues the Commission erred by looking at whether MFSW **actually** provides tandem and common transport instead of looking at whether MFSW's technologies perform functions **similar** to those performed by and ILEC's tandem switch.

MFSW also alleges the Commission misinterpreted the FCC rule in determining whether MFSW served a comparable geographic area to Pacific. The FAR reasoned that "the issue of whether MFSW is serving a comparable geographic area applies to the transport between the point of

interconnection and MFSW's switch (or equivalent) serving the called customer." MFSW argues that the rule requires that the Commission consider whether MFSW's network provides similar functionality as Pacific's tandem switch on the MFSW network side of MFSW's switch, not between MFSW's switch and Pacific's switch from the point of interconnection.

MFSW faults the Decision for noting that many of MFSW's customers are not served by fiber rings, and noting that ISPs served by MFSW are actually collocated with MFSW's switch. MFSW claims this consideration is not permitted by the FCC's rule. According to MFSW, the FCC rule does not contemplate a customer by customer determination of the geographic reach of MFSW's switches, but the overall reach of its switches to all the customers served by its switches.

MFSW also takes issue with the FAR's reasoning that MFSW's proposal is in conflict with the Commission's and FCC's prohibition on recovery of reciprocal compensation for nontraffic-sensitive loop costs. "Although the addition of new customers will require the addition of loop plant costs, the level of traffic, itself, does not increase loop costs. Thus, MFSW shall not be entitled to reciprocal compensation for its loop plant." (FAR at 80.) MFSW argues that the FCC does not recognize any such conflict. According to MFSW, the FCC's prohibition on recovery of non-traffic sensitive loop costs applies to the incumbent LEC's loop plant from an incumbent LEC's end office switch to its customers. MFSW argues it has never been applied to the network of switching, transport nodes and long loops which constitute the new and different network architecture of MFSW.

MFSW's arguments are unconvincing. As the above paragraphs from the DAR and the FAR demonstrate, the Commission did correctly consider whether MFSW's network provides similar functionality and is geographically comparable to Pacific's. MFSW provides no support for its narrow interpretation of the FCC rules. Whether a switch performs as a tandem or end office switch is a factual determination expressly delegated to state commissions. The rules do not specifically lay out what factors are relevant in determining functional equivalency or geographic comparability.[16] Nor do the rules specify which portions of a carrier's network must be compared in considering geographic coverage.

The factors of which MFSW complains are all relevant to determining the functional and geographic similarity of MFSW's switch to Pacific's network. The Commission's consideration of the fact that many of MFSW's customers were collocated is relevant to the question of location of customers and geographic area actually served by MFSW's switch. Moreover, whether customers are served by fiber rings is relevant to whether MFSW's switch acts as a tandem for these customers. MFSW's assertion that the FCC's rule does not permit consideration of these facts is unsupported.

[16] For example, in MCI Telecommunications v. Michigan Bell Telephone, 79 F.Supp.2d 768 (E.D. Mich. 1999), MCI argued the state commission should have compared the capacity of its fiber ring with just one of the ILEC's tandem switches, rather than all of the ILEC's tandem switches. The court noted that "the language of the FCC regulation is not clear on this point. It refers to the incumbents tandem switch as though there is just one." Id., at 791, fn. 15. In U.S. West Communications, Inc. v. PSC of Utah, 75 F.Supp.2d 1284 (Dist. Utah 1999), U.S. West argued it was impermissible for the Texas PSC to compare the CLC's switch with U.S. West's tandem switches and end office switches, as they operate together, rather than just the tandem switches standing alone. The court found that U.S. West approached the matter "too myopically," finding that in performing a functional similarity analysis, state commissions are not limited to considering only the first layer of an ILEC's system. Id., at 1290.

MFSW's arguments really boil down to a dispute over the weight of the evidence supporting the Decision's findings on this matter. The Commission heard evidence presented by both parties and did not find MFSW's evidence convincing. MFSW simply did not produce sufficient evidence that its switch functioned similarly to or served an area comparable to Pacific's. The fact that MFSW disagrees with the Commission's findings does not establish legal error in the Decision. The Decision's factual findings concerning whether MFSW's network functions as a tandem are reviewed under the arbitrary and capricious standard, if challenged in federal court. See U.S. West v. MFS Intelenet, Inc., et al., 193 F.3d 1112, fn. 15 (9th Cir. 1999). The FAR and the Decision cite to testimony and evidence in the record which support the Decision's conclusion that MFSW's switch does not function similarly to Pacific's switch, and does not serve a geographically comparable area. Because there is substantial evidence supporting the Commission's factual findings, the Decision is not arbitrary or capricious.

Collocation Prices Subject to True-up

MFSW next alleges that the Decision errs by setting many of the prices for collocation based on Pacific's tariff charges and failing to make those prices subject to true up and adjustment retroactive to the effective date of the interconnection agreement. As such, MFSW claims many of the prices for collocation are not based on Total Element Long Run Incremental Cost (TELRIC), in violation of the pricing standard of § 252(d) of the Act, 47 CFR §§ 51.501, 51.503, and 51.505, and the Commission's own pricing standard adopted in D.98-02-106.

MFSW argues that the Decision should be modified to make all prices for collocation subject to true-up, retroactive to the effective date of

the agreement. The DAR noted that the final prices applicable to collocation were still being litigated in the OANAD proceeding. The DAR stated that,

> [r]ather than attempt to second-guess the outcome of the OANAD proceeding, the interim collocation prices charged to MFSW shall be based on the prices being offered to all other CLCs pursuant to Pacific's Accessible Letter. For purposes of this arbitration, these interim prices shall be subject to true-up based on the outcome of the collocation pricing phase of OANAD. **Any subsequent interim prices charged to MFSW as set in Pacific's collocation tariffs shall also be subject to true up. Pacific has failed to justify exempting tariffed collocation prices from the true up process.**

DAR at 36. The FAR deleted these last two sentences without explanation. The Decision itself repeats MFSW's argument that without a true-up, the collocation prices violate the pricing standards set forth in the Act. However, the Decision does not address this argument at all.

In its response, Pacific contends that MFSW ignores 47 CFR § 51.513, which allows the Commission to adopt collocation prices without a true-up if the prices meet the proxies set by that rule. According to that rule, the collocation proxies "shall be no greater than the effective rates for equivalent services in the interstate expanded interconnection tariff." 47 CFR § 51.513(c)(6). Under this rule, the Commission can adopt collocation prices without any need for a true-up, if such prices are the same or lower than Pacific's FCC-approved interstate collocation prices. Pacific points out that the Interconnection Agreement approved by the Decision allows MFSW to order out of either Pacific's FCC-approved or Commission-approved tariffs. (Interconnection Agreement filed August 11, 1999, Appendix Collocation, Sections 7.1(a), 7.1(b).) According to Pacific, since

MFSW can order collocation from either the FCC-approved or Commission-approved tariffs, MFSW can choose prices that meet the FCC's rules. Alternatively, Pacific argues, the Decision could be modified, not to provide for a true up, but to provide that the FCC-approved prices apply when MFSW orders collocation for intrastate purposes.

MFSW is correct that collocation prices in Pacific's effective Commission-approved tariffs are not based on TELRIC. The tariffs that are being set currently in the OANAD proceeding will be based on TELRIC, but unless there is a true-up, the interim collocation prices will not be based on TELRIC as required by the Act.

Although Pacific is correct that 47 CFR § 51.513 allows collocation prices without true-up if the prices meet the proxies set by that rule, there is no indication in either the DAR, FAR or the Decision that the Commission was relying on the proxies set in § 51.513 to set collocation prices. That section also requires the state commission to set forth in writing a reasonable basis for its selection of a particular rate for the element. 47 CFR § 51.513(a)(2). There does not appear to be any explanation provided pursuant to that section.

However, we find that this situation can be resolved by directing the parties to limit collocation pricing to Pacific's federal tariffs. As Pacific points out, the agreement provides MFSW the option of ordering out of either Pacific's Commission-approved or FCC-approved tariffs. Ordering out of the Commission-approved tariff would require a true-up. However, we are concerned that allowing one party a refund off tariffed charges while potentially denying the same treatment to other parties might raise serious discriminatory problems. Therefore, the Decision shall be

modified to provide that the FCC-approved prices apply when MFSW orders collocation for intrastate purposes.

CONCLUSION

As discussed above, we have found that Pacific Bell's application for rehearing fails to state sufficient grounds for rehearing. MFSW's application for rehearing shall be granted, in part, in order to modify the Decision to provide a true-up for collocation prices in the interconnection agreement. As modified, MFSW's application for rehearing shall be denied. Therefore,

IT IS ORDERED that:

1. Decision 99-09-069 is modified as follows:

   A. The first full paragraph on page 17 is modified to read:

   > "MFSW is correct that collocation prices in Pacific's effective Commission-approved tariffs are not based on TELRIC. However, we find that this situation can be resolved by directing the parties to limit collocation pricing to Pacific's federally-approved tariffs. Pacific offers MFSW to order out of either Pacific's FCC-approved or Commission-approved tariffs. Ordering out of the Commission-approved tariff would require a true-up. However, we are concerned that allowing one party a refund off tariffed charges while potentially denying the same treatment to other parties might raise serious discriminatory problems. On the other hand, the FCC-approved tariffs meet the FCC's pricing rules and would not require a true-up. We shall accordingly require that Pacific's FCC-approved tariff prices apply when MFSW orders collocation for intrastate purposes."

   B. Conclusion of Law No. 19 is modified to read:

   > "The referencing of Pacific's currently effective Commission-approved tariffs would not meet the FCC's pricing rules and would require a true-up.

> Providing MFSW a refund off Commission-approved tariffed charges may raise serious discrimination problems. However, the referencing of Pacific's FCC-approved collocation tariffs in the Agreement is appropriate since they meet the FCC's pricing rules and do not require a true-up."

2. The parties are directed to jointly file an amended interconnection agreement which conforms to the Decision, as modified. The parties shall make appropriate changes in the Collocation Appendix, and any other applicable references in the agreement, to provide that Pacific's FCC-approved tariff prices apply when MFSW orders collocation for intrastate purposes.

3. Rehearing of Decision 99-09-069, as modified, is hereby denied.

This order is effective today.

Dated May 18, 2000, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
Commissioners

I dissent.
/s/ JOSIAH L. NEEPER
Commissioner